Public finance in democratic process

The origins of public finance, as a field of study though most certainly not as an object of practice, can be traced to the emergence of the cameralists after 1500 in central Europe (Backhaus and Wagner 1987). The focal point of cameralist concern was on survival of the regime, which in turn, required a military capacity and economic development. This concern about development took place within absolutist regimes that existed in a highly competitive, Tiebout-style (1956) environment. The Peace of Westphalia in 1648, for instance, recognized more than 300 independent units of governance within the cameralist lands. Joseph Schumpeter (1954, pp. 143-208) described the cameralists well when he referred to them as "Consultant Administrators." They were both consultants and administrators. They were consultants to the various kings, princes, and other royal personages who ruled throughout those lands. The cameralists were not, however, anything like contemporary academic consultants. They were real-world administrators as well. They were engaged in such activities as managing mines or glass works. Many of the cameralists also held academic posts (as noted in Albion Small's (1909) thorough but more descriptive than analytical examination).

If one were to construct a model of the cameralist vision of the state, it would look like a model of a business firm. The state's lands were potential sources of revenue. Forests could be harvested, game could be caught, and mines could be worked. The ruler would also sponsor an assortment of commercial enterprises, as in operating a glassworks or a brewery. Taxes

occupied a secondary position as a source of revenue. They were a last resort option for public finance, and not the first source of revenue.

The cameralist absolutisms have long given way to democracies throughout the Western world. In many respects, however, public finance has not kept pace with this change in political regime. Cameralistic public finance was a choice-theoretic approach to public finance. The phenomena of public finance, state revenues and expenditures, arose out of some ruler's optimizing choices. It is quite different in modern democratic regimes. The phenomena of public finance do not arise from someone's optimizing choice, but rather arise through interaction among the many participants within the fiscal process. This interactive or catallactic approach to public finance leads often to quite different implications for public finance than does the choice-theoretic approach (Wagner 1997). A good deal of contemporary public finance has maintained the choice-theoretic orientation toward public finance, as if fiscal phenomena are still generated through the same processes that were in place in mercantalistic and cameralistic times. This astonishing situation was noted in 1896 by Knut Wicksell (1958, p. 82), when he observed that the theory of public finance "seems to have retained the assumptions of its infancy, in the seventeenth and eighteenth centuries, when absolute power ruled almost all Europe."

The distinction between a choice-theoretic and a catallactic orientation toward fiscal phenomena is a central fault line that runs throughout contemporary public finance. The seminal articulation of the choice-theoretic orientation can be attributed to the British economist Francis Edgeworth (1897). The seminal

articulation of the catallactic orientation can be attributed to the Swedish economist Knut Wicksell (1896). While both of these authors are now more than a century behind us, their central orientations toward public finance are readily visible in contemporary fiscal scholarship.

The Edgeworthian, choice-theoretic orientation treats public finance as the study of government intervention into the economy, typically expressed as maximizing some form of social welfare function. In particular, Edgeworth raised the question of how a government would impose taxes within a nation if it wanted to raise those taxes with a minimum amount of sacrifice to taxpayers. For a given amount of revenue to be raised, Edgeworth's ideal state would be one that imposed the least amount of sacrifice upon taxpayers in raising its revenue. This Edgeworthian, choice-theoretic approach to public finance treats the phenomena of public finance as arising from the maximizing choices of a benevolent entity, the state. The state stands outside the market economy and its participants. The people who participate in the market economy may write the first draft, so to speak, but it is the state that revises and perfects the manuscript.

The Wicksellian, catallactical orientation treats public finance as the study of how people participate through government to achieve their various ends (Wagner 1988). This orientation, with its emphasis on fiscal institutions in place of the Edgeworthian emphasis on resource allocations, is illustrated with striking lucidity in James Buchanan (1967). The state does not stand above the market economy and its participants. The same people who participate in the market economy participate in state governance as well. Fiscal phenomena are not the

product of some ruler's maximizing choices, but rather emerge through interaction among people. This interaction might be beneficial for everyone or nearly everyone, or it might be beneficial for only a few, and costly for many others. The state is treated as a nexus of contractual and exploitive relationships. The extent to which those relationships are contractual or exploitive depends on the constitutive structure of governance that is in place.

As a matter of general principle, political relationships are both contractual and exploitive. It is fine to say that taxes are the prices we pay for civilization, to recall the inscription attributed to Oliver Wendell Holmes that is chiseled above the main entrance to the headquarters of the Internal Revenue Service in Washington, D.C. This doesn't mean, however, that the relationship between citizens and state is the same as the relationship between customers and the retail outlets they frequent. A customer can refuse to buy and, moreover, generally can return merchandise that turns out to be defective or otherwise unsatisfactory. There is no option to do this in politics. To say that civilization is being priced too highly and to withhold payment will only land the protester in prison. And there is certainly no point in asking for a refund by claiming that the state's offerings weren't as good as its advertisements claimed them to be.

To speak of a catallactical approach to public finance is not to claim that the phenomena of public finance arise through voluntary interaction among people. It is only to say that those phenomena arise through interaction among people, the very same people as who interact with one another within the market economy. Much of the phenomena of public finance surely arise through duress

and not through genuine agreement. This aspect of duress was given particular stress in a good deal of the Italian scholarship on public finance, and which is surveyed in James Buchanan (1960).

Within the Wicksellian, catallactical tradition, primacy of analytical attention is placed upon the institutions of governance, both market governance and, especially, political governance. This contrasts sharply with the Edgeworthian, choice-theoretic tradition where the primary analytical attention is placed upon prices and resource allocations. The state is not treated as some exogenous force that perfects and corrects the outcomes of the market economy. The actual fiscal conduct of the state emerges through complex interactions among fiscal and political participants, and the precise character of those interactions is constrained and shaped by a governing institutional and constitutional framework.

A choice-theoretic approach to public finance was suitable in cameralist and mercantilist times. A cameralist ruler could reasonably be described as seeking to use his fiscal means to promote his dynastic ends. For the cameralists it was historically accurate to ascribe the phenomena of public finance to the choices of the rulers. The state's revenues depended on the ruler's choices about how to operate his mines and how to farm his lands. The extent to which state expenditures were directed to projects that might increase future productivity were likewise objects of choice for the ruler. Suppose two kingdoms were observed to undertake different expenditure programs. In Primo's kingdom, expenditures were heavily oriented toward such investments

as draining swamps and building roads that would be likely to increase future production. The budget in Secundo's kingdom, however, did little about swamps and roads, and instead spent lavishly on amusements for Secundo and his court. It would be reasonable in this case to compare the budgetary choice of the two kingdoms, and to say that Primo had a lower time preference, or was otherwise more far-sighted than Secundo. To the extent it is possible to make inferences about preferences from the observation of choices with respect to private choices, it would be possible to do the same thing with respect to state choices within the cameralist setting. To be sure, the conduct of cameralist rulers was relatively civilized, and nothing like the experience with dictators in the 20th century. The conceptual construction of a benevolent despot perhaps finds historical validation in the cameralist period. That does not, however, validate the use of constructions based on benevolent despots in public finance today.

Whether budgets are tilted toward amusements or capital projects would not be directly a source of information about some ruler's preferences in a democratic regime. Budgets emerge out of interactions among participants, and those interactions are governed and shaped by a variety of procedural and constitutive rules. The people who participate in a market make their various choices, but it makes no sense to speak of the market itself as making choices. The market simply registers and reflects the choices and interactions among the participants. It is the same with budgetary outcomes within a democracy. Furthermore, the same set of people can generate quite different budgetary outcomes, depending on the institutional framework within which the budgetary

process proceeds. In this respect, there are an indefinitely large number of particular budgetary processes that can be imagined, and it is conceivable that a wide variety of budgetary outcomes could be generated, if the experiment were performed of having the same people engage in successive interactions across differing institutional frameworks. This consideration suggests immediately that a post-cameralist public finance would place particular importance and significance on the institutional framework within which fiscal outcomes emerge.

Taxation is most surely a Faustian bargain, as Vincent Ostrom (1984) explains. Excess burden is one of the primary tools that is employed in public finance. The claim on behalf of excess burden is that taxes have burdens beyond the burden associated with the revenues that taxes collect, due to the changes in market choices that people make in response to taxation. Despite the widespread use that is made of excess burden analytics, the concept suffers from some deep institutional problematics within a democratic political system, as Richard Wagner (forthcoming) explains. In a pure Wicksellian framework, public projects are approved to the extent that political participants value the resulting public programs more highly than they value the private alternative they had to sacrifice. It simply makes no sense to speak of excess burden in a Wicksellian-like institututional setting. In non-Wicksellian settings, the democratic fiscal process involves significant elements of domination and subordination. Those who are subordinated may well bear costs beyond the gains that are attained by the dominating classes, but this is simply to say that any process by which some people are taxed for the benefit of others will involve costs beyond the directly

observed budgetary magnitudes. There is nothing surprising about this. Taxation transforms private property governance into common property governance (Wagner 1992), and the balanced budget multiplier that results from this transformation is generally negative. Taxation does truly represent a Faustian bargain, particularly outside the framework of Wicksellian or consensual governance.

Richard E. Wagner
Holbert L. Harris Professor of Economics
George Mason University
Fairfax, Virginia, U.S.A.

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